

## **DEFENSE CONTRACT AUDIT AGENCY**

### **AUDIT PROGRAM FOR COST ACCOUNTING STANDARD NO. 409 DEPRECIATION OF TANGIBLE CAPITAL ASSETS**

Contractor's Name: \_\_\_\_\_

Assignment Number: \_\_\_\_\_

Field Audit Office: \_\_\_\_\_

Date Assigned: \_\_\_\_\_

Auditor Assigned: \_\_\_\_\_

\_\_\_\_\_  
Supervisor's Signature Indicating  
Approval (Obtain Signature Before  
Starting Audit)

Note: Those steps not required should be marked "not applicable" (N/A). Portions of the audit, which are covered in other assignments (e.g., incurred cost, Disclosure Statement, and internal control audits), should be referenced at the appropriate place in this program.

#### **A. PURPOSE AND SCOPE**

1. The purpose of CAS compliance auditing is to determine if the contractor's policies, procedures, and practices used to estimate, accumulate, and report costs on government contracts and subcontracts comply with the requirements of CAS. CAS 409 establishes criteria for assigning costs of tangible capital assets to cost accounting periods and for allocating such costs in an objective and consistent manner. The standard does not apply where compensation for tangible capital asset usage is based on use allowances as provided in Office of Management and Budget Circular Nos. A-21, A-87, and A-122 or other appropriate acquisition regulations. Nor does it cover nonwasting assets or natural resources which are subject to depletion. FAR 52.230-2, Cost Accounting Standards, requires the contractor to comply with the CAS 409 criteria. Because of the interrelationship and to achieve efficiency, CAS 404 and CAS 409 should be audited concurrently.
2. The scope of this audit should generally be limited to contractor's current fiscal year (CCFY). Some limited testing of prior years' unaudited transactions may be appropriate to assure that no system changes were made or noncompliances exist. For efficiency, CAS compliance testing, if possible, should be performed concurrently with tests for compliance with FAR and contract terms.

3. This program is intended to provide for the proper planning, performance, and reporting on the contractor's compliance with CAS 409. The audit steps in the program should reflect a documented understanding between the auditor, the technical specialist, as applicable, and the supervisor as to the scope required to comply in an efficient and effective manner with generally accepted auditing standards and DCAA objectives. The program steps are intended as general guidance and should be tailored as determined by audit risk.

## **B. AUDIT PLANNING CONSIDERATIONS**

1. Before beginning any CAS compliance audit, the auditor should first determine whether the contractor is subject to the CAS coverage. If the standard is not applicable to the contractor or noncompliance with the standard overall has no significant impact on government contract costs, there is no need to test whether the contractor is complying with the standard. The decision to not test for CAS compliance should be documented (see CAM 8-305 and DoD CAS Working Group Guidance Paper 76-7).
2. Materiality (see 48 CFR 9903.305) and audit risk assessment (including Internal Control Audit Planning Summary (ICAPS) for major contractors, Survey of Contractor's Organization, Accounting System, and System of Internal Controls (SHORTICQ) for nonmajors, and historical CAS problems) are integral parts of the planning process and should be considered in developing the extent and frequency of CAS compliance tests.
3. Once it is determined that the standard is applicable and material to the government, the auditor should assess which provisions of the standard are significant to the contractor; the extent reliance may be placed on the contractor's system of internal controls to ensure compliance; and the results of other relevant audits (e.g., results of prior compliance audits, Disclosure Statement revisions, etc.). The decision to not test whether the contractor is complying with specific provisions of the standard should be documented.

## C. PRELIMINARY AUDIT EFFORT

### 1. Research and Planning

- a. Read and become familiar with the criteria in CAS 409, CAM 8-409, and any recent Headquarters guidance not incorporated in CAM. Identify any changes in the CAS 409 standard since the last examination.
- b. Evaluate Parts IV and V of the contractor's Disclosure Statement items to become familiar with the disclosed accounting practices. Determine if the contractor's disclosed practices have changed since the last CAS 409 compliance audit. If changes have occurred, document the file and adjust audit scope accordingly.
- c. Determine whether the total depreciation expense is material. Consider contract mix (government vs. commercial) when determining costs subject to this standard are material. If the audit is discontinued due to insignificant impact on government contracts, document the permanent files and appropriate requirements plan working papers in accordance with CAM 8-305.2.
- d. Examine information included in FAO files to determine what data are available, what audit steps were done in the past, and the results from those steps. This will identify areas of high risk and/or areas where limited or no compliance testing is necessary. Files to evaluate include:
  - (1) Prior audit work packages (such as, prior CAS compliance, Disclosure Statement, and incurred cost audits)
  - (2) FAO permanent files (including ICAPS, SHORTICQ, ICM-ACTG, and MAARs)

Control Log). (Applicable MAARs 1, 3, 4, 5, 15, and 16.)

- e. Coordinate with FAO technical specialist and/or regional specialist on matters of interpretation and policy.
- f. Discuss the planned compliance audit with the administrative contracting officer and, if appropriate, other customers to identify, understand, and document any concerns they may have or areas which should be evaluated.

## 2. Entrance Conference and Preparation

- a. Arrange and conduct an entrance conference covering the areas highlighted in CAM 4-302 with particular emphasis on obtaining an understanding of the contractor's depreciation process and its internal control structure. Request the contractor to explain the following:
  - (1) Its depreciation process including disposition of assets and identify relevant written policies and procedures
  - (2) Any changes, or planned changes, to policies and procedures related to CAS 409 since the last DCAA examination
  - (3) Any corrective actions related to previously identified noncompliances
  - (4) Fixed asset retirement report
- b. If reliance is to be placed on the work of others, the file should contain the required documentation (see CAM 4-1000).

## 3. Risk Assessment

- a. Gain an understanding of the contractor's internal control structure by reviewing relevant ICAPS or SHORTICQ (whichever is

applicable). Identify any known deficiencies.  
Assess the control risk.

- b. If the contractor is classified as non-major (where ICAPS have not been completed) and if the evidential matter to be obtained during the audit is highly dependent on computerized information systems, document the audit work performed that supports reliance on the computer-based evidential matter. If the contractor's controls related to these systems have not been specifically/adequately tested in other audits, the auditor needs to either (1) develop, document, and reference in B-2 the procedures/tests in this audit that will support reliance on the evidential matter or (2) qualify the audit in accordance with CAM 10-210.4a and 10-804.4a.
- c. Document assessment of the contractor's internal control structure relative to this standard (control environment, accounting system, and relevant policies, procedures, and practices) to assure compliance with laws and regulations.
- d. Determine high-risk areas by performing the following:
  - (1) Determine the dollar amounts in the various accounts.
  - (2) Perform comparative analysis of the identified accounts to determine if significant changes may have occurred
  - (3) Determine Provisions of the standard that are material.
- e. In planning and performing the examination, review the fraud risk indicators in CAM Figure 4-7-3 for applicability to this audit. Document in working paper B any identified fraud risk indicators and your

response/actions to those identified risks (either individually, or in combination). This should be done at the planning stage of the audit as well as during the audit if risk indicators are disclosed. If no risk indicators are identified, document this in working paper B.

- f. From the information gathered in the preceding steps, assess the audit risk and determine the scope of audit and extent of compliance testing to be performed.
- g. Update the information in the permanent files as needed.

#### **D. DETAILED AUDIT REQUIREMENTS**

Determine that the depreciation cost of a tangible capital asset (or group of assets) is assigned to cost accounting periods in accordance with the following criteria:

1. Measurement of Depreciable Cost
  - a. Verify that the contractor determines the depreciable cost of a tangible capital asset to be its capitalized cost less its estimated residual value. Residual Value is the current forecast of the proceeds (less removal and disposal costs, if any) to be realized upon disposition of a tangible capital asset. It usually is measured by the net proceeds from the sale or other disposition of the asset, or its fair value if the asset is traded in on another asset (CAS 409.40(a)(1)).
  - b. Verify the acquisition cost by examining the supporting detailed asset ledger or to other supporting documentation, such as purchase

orders, vendor invoices, or canceled checks. Capitalized cost should be the acquisition cost of the asset, adjusted for additions and retirements. Note: The capitalized cost should include inspection, testing, installation, etc., if material.

- c. Verify that the contractor's estimated residual values are determined for all tangible capital assets (or group of assets). For tangible personal property, only estimated residual values which exceed ten percent of the capitalized cost of the asset (or group of assets) need be used in establishing depreciable costs. Also, residual value need not be considered in determining depreciable costs if the declining balance method of depreciation or the class life asset depreciation range method is used. (CAS 409.50(h)).
- d. Verify for newly acquired tangible assets that the contractor did not begin to charge depreciation until the assets were ready for use. (CAS 409.50(b)).
- e. Verify that the contractor does not charge depreciation cost which would significantly reduce the book value of an asset or group of assets below residual value (CAS 409.50(h)).
- f. If the contractor changed the estimated service life, residual value or method of depreciation during the life of a tangible capital asset, determine if the contractor limited the remaining depreciable cost for cost accounting purposes to the undepreciated cost of the assets and assigned this cost only to the cost accounting period in which the change is made and subsequent periods (CAS 409.50(i)).

		<u>Staff Hours</u>	<u>W/P</u>	<u>Auditor's</u>
		<u>Budget</u>	<u>Actual</u>	<u>Initials</u>
			<u>Ref</u>	<u>and Date</u>
				<u>Completed</u>
g.	Verify that the contractor is consistently following its policy in determining the depreciable cost to be assigned to the beginning and ending periods of asset use (CAS 409.50(c)). The auditor should compare the treatment of newly acquired and disposed of tangible capital assets' depreciation for the current period to the contractor's prior year's policy.			
2.	<u>Estimated Service Lives</u>			
a.	Verify that the estimated service life of a tangible capital asset (or group of assets) was used to determine the cost accounting periods to which the depreciable cost will be assigned (CAS 409.40(a)(2)).			
b.	Verify that the contractor estimated its tangible capital assets' service lives by determining a reasonable approximation of their expected actual periods of usefulness. The contractor's determination should consider the following physical and economic factors which may be taken into account (CAS 409.50(a)):			
	(1) Quantity and quality of expected output, and the timing thereof,			
	(2) Costs of repair and maintenance, and the timing thereof,			
	(3) Standby or incidental use, and the timing thereof, and			
	(4) Technical or economic obsolescence of the asset (or group of assets), or of the product or service it is involved in producing.			
	(5) The estimate of the expected actual period of usefulness need not include the additional period tangible capital assets are retained for standby or incidental use where adequate records are maintained which reflect the			



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withdrawal from active use (CAS 409.50(e)).				
(6) Actual periods of usefulness shall be those periods which are supported by adequate records of past usage for a sample of like assets used in similar circumstances appropriately modified for specifically identifiable factors expected to influence future lives (CAS 409.50(e)(1)).				
c. Verify that the contractor's basis used for estimating service lives is predicated on supporting records of experienced lives and consistently used (CAS 409.50(e)(2)).				
d. Verify that the contractor developed the assets estimated useful life from history developed from current and historical fixed asset records. Note: Such records must be available <u>2 years</u> after the Standard is to be followed. Estimated service lives for financial accounting purposes, if not unreasonable, shall be used until adequate supporting records are available (CAS 409.50(e)(3)).				
e. If the contractor has no available data, determine if the estimated service lives for tangible capital assets is established based on a projection of the actual period of usefulness, but is not less than asset guideline periods (mid-range) established for asset guideline classes under Revenue Procedure 72-10 and any additions, revisions, supplements, etc (CAS 409.50(e)(4)).				
f. Determine that the estimated service life and method of depreciation used for an original complement of low-cost equipment is based on the expected consumption of services over the expected useful life of the complement as a whole and is not based on the individual				

items which form the complement (CAS 409.50(g)).

- g. Determine if depreciable spare parts which are required for the operation of tangible capital assets are accounted for over the service life of such assets (CAS 409.50(b)).

### 3. Method of Depreciation

Determine that the method of depreciation selected reflects the pattern of consumption of services over the life of the asset (CAS 409.40(a)(3)).

- a. The appropriate method of depreciation should be selected as follows:
  - (1) An accelerated method of depreciation is appropriate where the expected consumption of asset services is significantly greater in early years of asset life (CAS 409.50(f)(3)(i)).
  - (2) The straight-line method of depreciation is appropriate where the expected consumption of asset services is reasonably level over the service life of the asset (or group of assets) (CAS 409.50(f)(3)(ii)).
- b. The method of depreciation used for financial accounting purposes shall be used for contract costing unless (CAS 409.50(f)(1)):
  - (1) Such method does not reasonably reflect the expected consumption of services for the tangible capital asset to which applied, or
  - (2) The method is unacceptable for Federal Income Tax purposes.

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c.	After the date of initial applicability of this Standard, selection of methods of depreciation for newly acquired assets which are different from the methods currently being used for like assets in similar circumstances shall be supported by projections of the expected consumption of services of those assets to which the different methods of depreciation shall apply (CAS 409.50(f)(2)).			

#### 4. Accounting for Gains and Losses

Determine that the gain or loss recognized upon disposition is assigned to the cost accounting period in which the disposition occurs (CAS 409.40(a)(4)).

- a. The gain or loss for each asset disposed of is the difference between the net amount realized, including insurance proceeds in the event of involuntary conversion, and its undepreciated balance. However, the gain to be recognized for contract costing purposes shall be limited to the difference between the original acquisition cost of the asset and its undepreciated balance (CAS 409.50(j)(1)).
- b. Gains and losses on the disposition of tangible capital assets shall not be recognized where (CAS 409.50(j)(2)):
  - (1) Assets are grouped and such gains and losses are processed through the accumulated depreciation account or,
  - (2) The asset is given in exchange as part of the purchase price of a similar asset and the gain or loss is included in computing the depreciable cost of the new asset.
- c. Where the disposition results from an involuntary conversion and the asset is

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replaced by a similar asset, gains and losses may either (CAS 409.50(j)(2)):				
(1) Be recognized in the period of disposition, or				
(2) Used to adjust the depreciable cost base of the new asset.				
d.	The contracting parties may account for gains and losses arising from mass or extraordinary dispositions in a manner which will result in treatment equitable to all parties (CAS 409.50(j)(3)).			
e.	Gains and losses on disposition of tangible capital assets transferred in other than an arms-length transaction and subsequently disposed of within <u>12 months</u> from the date of transfer shall be assigned to the transferor (CAS 409.50(j)(4)).			
f.	Gains and losses are not recognized in business combinations taking place after the applicability date of the 15 April 1996 revision to CAS 409, if the assets generated either depreciation expense or cost of money charges during the most recent cost accounting period prior to a business combination.			

##### 5. Allocation of Depreciation Cost

The auditor should verify that the annual depreciation cost allocation, including the allocation of gains and losses, is allocated to cost objectives on a beneficial or casual relationship in accordance with the following criteria (CAS 409.40(b)):

- a. Depreciation cost may be charged directly to cost objectives only if such charges are made on the basis of usage and only if

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depreciation costs of all like assets used for similar purposes are charged in the same manner.				
b.	Where tangible capital assets are part of, or function as, an organizational unit whose costs are charged to other cost objectives based on measurement of the services provided by the organizational unit, the depreciation cost of such assets shall be included as part of the cost of the organizational unit.			
c.	Depreciation costs which are not allocated in accordance with a. and b. above shall be included in appropriate indirect cost pools.			
d.	The gain or loss which is recognized upon disposition of a tangible asset, where material in amount, shall be allocated in the same manner as the depreciation cost of the asset has been or would have been allocated for the cost accounting period in which the disposition occurs. Where such gain or loss is not material, the amount may be included in an appropriate indirect cost pool.			

## **F. CONCLUDING AUDIT STEPS**

1. Summarize the results of audit.
2. Discuss results with the supervisor or the FAO technical specialist. The auditor should only report those noncompliances which are considered material (see CAM 8-302.7).
3. Coordinate significant or unusual issues with the ACO, FAO Manager, and if applicable, with the CAC, CHOA, or GAC network (see CAM 8-302.4 & 8-302.6). Coordination should be both before and after discussion of results with the contractor. The ACO should be apprised of

			Auditor's Initials and Date Completed
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	<u>Budget</u> <u>Actual</u>	<u>Ref</u>	

noncompliance matters at the earliest possible date. If a noncompliance is considered immaterial, recommend to the ACO that the contractor be notified to reserve the Government's right should the cost impact become material (see FAR 30.602).

4. Prepare draft audit report in accordance with CAM 10-805 (activity code 194XX) when no instances of noncompliances are found, or CAM 10-806 (activity code 19200) when instances of noncompliances are found. If scope was limited to certain provisions of standard, modify scope and opinion statements as necessary.
5. Conduct an exit conference with the contractor in accordance with CAM 4-304.
6. Finalize audit report incorporating the contractor's response and audit rejoinder, if applicable.
7. Closing actions should be performed in accordance with FAO procedures. These procedures may require either auditors or administrative personnel to perform various closing steps. Completion of these closing actions should be documented in the working papers and should include:
  - a. If the audit report has been electronically transmitted to the customer, file the signed original report in the audit working paper package. Otherwise, file a copy of the signed report.
  - b. Include a printed copy of the final draft audit report containing the supervisory auditor's initials and date on the top page, cross-referenced to the working papers, in the working paper package. The final draft report should include all substantive changes made to the original draft, with

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cross-referencing updated as necessary. It should differ from the final report only due to minor administrative changes (spelling, format, etc.) made during final processing.				
c.	Include an electronic version of the acknowledgement letter in the audit working paper package.			
d.	Include hardcopy printouts of the Administrative and Audit Working Papers indexes, including the supplemental listing of electronic files, in the working paper package.			
e.	Ensure all working paper files are "read only" and, if necessary, compressed for final storage. Generally, current Agency software should be used to automatically modify all electronic files for storage.			
f.	Two complete sets of electronic working papers must be prepared. The "original" set should be stored in the working paper package. The "archive" set is to be stored separately from the working paper package on removable media such as CD-ROM or diskette. If there will be a short-term need to access the working papers, a third, or "working" set should be stored so as to be available for reference, generally on the LAN. This set should be deleted when no longer needed.			
g.	Verify that electronic files stored on removable media are not corrupted and can be unarchived.			
h.	Securely enclose the "original" set of electronic files in the working paper package.			

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8. Update the permanent files, i.e., ICAPS or SHORTICQ, and Mandatory Annual Audit Requirements (MAARs) schedules. <i>Ensure that a copy of DMIS Report No. CAS 3 entitled "CAS Compliance Testing (Activity Code 194XX)" is included in the permanent file after the assignment has been closed in DMIS.</i>				

**TOTAL HOURS**